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BANKRUPTCY LAW

OVERVIEW

A record number of bankruptcy petitions were filed in the bankruptcy courts under the appellate jurisdiction of the Tenth Circuit Court of Appeals for the fiscal year October 1, 1983 to September 30, 1984. In that period, debtors filed 23,062 new petitions.[1] For the fiscal years 1981-82 and 1982-83, there were respectively 20,086 and 22,191 new cases filed.[2] The increasing number of appeals from the bankruptcy courts to the Tenth Circuit reflects this heavy caseload. This survey will focus primarily on the published opinions which were handed down by the Tenth Circuit within the survey period.

Many of the cases discussed in this survey contain issues raised by the numerous changes, legal and judicial, in the bankruptcy system since the 1898 Bankruptcy Act was repealed by the Bankruptcy Reform Act of 1978.[3] Several cases deal with the impact of state law on federal bankruptcy law. Where pertinent, this survey notes further changes in the bankruptcy system due to the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984[4] on July 10, 1984.

I. JURISDICTION AFTER *MARATHON*

A. *Background*

The Bankruptcy Reform Act of 1978 established a new bankruptcy court system which gave bankruptcy judges the authority that was previously shared by bankruptcy referees and federal district judges.[5] The old system established by the 1898 Act was wasteful and inefficient.[6] Cases were referred from the courts of bankruptcy (the United States district courts and territorial district courts) to the bankruptcy referee. The referee was given jurisdiction over the case "subject always to a

1. Telephone interviews with Clerks of Bankruptcy Court, Tenth Circuit (November, 1984).

2. Administrative Office of the United States Courts, Statistical Analysis and Reports Division, Federal Judicial Workload Statistics, A-47 (1982), A-43 (1983).

3. "The term 'Bankruptcy Code' is often used in connection with Title 11 of the United States Code as amended by Public Law No. 95-598. The numerous provisions of Public Law No. 95-598 that amend Title 28 of the United States Code have no common name or designation and will be referred to simply as . . . the Bankruptcy Reform Act." Kennedy, *The Bankruptcy Court Under the New Bankruptcy Law: Its Structure and Jurisdiction*, 11 ST. MARY'S L.J. 251 (1979), *reprinted in* 55 AM. BANKR. L.J. 63, 66 n.20 (1981).

4. Pub. L. No. 98-353, 98 Stat. 333 (1984).

5. *See* Northern Pipeline Co. v. Marathon Pipe Line Co., 458 U.S. 50, 53 (1982).

6. The years of study that lead to the passage of the 1978 bankruptcy law made clear that the two major failings of the prior bankruptcy referee system were the lack of simplicity in determining jurisdiction of the bankruptcy court and the low status and lack of power of the bankruptcy judges which resulted in disrespect for their position and inability to attract the best caliber judges. 130 CONG. REC. 7490 (daily ed. June 29, 1984) (statement of Rep. Edwards).

review by the judge" of the bankruptcy court.[7] The referee was also responsible for administrative duties under section 39a of the 1898 Act. The system resulted in duplication of effort and mixed judicial and administrative functions.

In order to make the bankruptcy process workable and efficient, the 1978 Reform Act abolished the referee system and created a newly structured and independent bankruptcy court. Congress hoped that the new system would attract highly qualified applicants to the judicial posts established, and that the role of these judges would be limited to judicial functions, thus resulting in increased fairness and less bias than under the referee system.[8] Also, in recognition of the specialized nature of bankruptcy and for the sake of judicial economy, the new bankruptcy court was given a pervasive grant of jurisdiction.[9]

There was one major problem with the 1978 Reform Act—the exercise of jurisdiction by the bankruptcy courts was unconstitutional. In June 1982, in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,[10] the Supreme Court held the jurisdictional component of the new system unconstitutional because article I bankruptcy judges were adjudicating rights and claims that only article III judges could constitutionally decide.[11] The ruling was prospective only, and the Supreme Court gave Congress over three months to remedy the situation.[12] When Congress failed to act, the Judicial Conference of the United States proposed a model interim operating rule which split jurisdiction between the district courts and the bankruptcy courts, depending on whether the case arose under title 11 or was a civil proceeding "related to"[13] cases under

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7. 11 U.S.C. § 66 (1976) (repealed 1978).

8. H.R. Doc. No. 137, 93d Cong., 1st Sess., Pts. I and II (1973).

9. *See* 28 U.S.C. § 1471(c) (1982).

10. 458 U.S. 50 (1982).

11. *Id.* at 87. U.S. Const. article III, section 1 states:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services a Compensation, which shall not be diminished during their Continuance in Office.

It is well established that the "good Behavior" language means that article III judges shall be appointed for life terms, "subject only to removal by impeachment." *Marathon*, 458 U.S. at 59 (citing Toth v. Quarles, 350 U.S. 11, 16 (1955)). Under the Reform Act, however, bankruptcy judges were appointed to 14-year terms and their salaries could be adjusted downward by Congress. *See* 28 U.S.C. § 153(a) (1982) (14 yr. term); 2 U.S.C. §§ 351-361 (1982) (salary adjustment).

For a more detailed analysis of the *Marathon* decision see Redish, *Legislative Courts, Administrative Agencies, and the* Northern Pipeline *Decision*, 1983 Duke L.J. 197 (1983).

12. *Marathon*, 458 U.S. 87-88. Judgment was stayed to afford Congress an opportunity to "reconstitute the bankruptcy courts or to adopt other valid means of adjudication, without impairing the interim administration of the bankruptcy laws." *Id.* at 88.

13. Consistent with *Marathon*, the interim operating rule defined related proceedings as follows:

> Related proceedings are those civil proceedings that in the absence of a petition in bankruptcy could have been brought in a district court or state court . . . . Related proceedings do not include: contested and uncontested matters concerning the administration of the estate; allowance of and objections to claims against the estate . . . .

title 11. In "related to" proceedings, a bankruptcy judge could only make findings and recommendations concerning a judgment.[14] A judgment became final only upon being signed by a federal district judge.[15]

This split of jurisdiction for bankruptcy issues led to a flood of litigation regarding what was and was not a "related to" proceeding. The Tenth Circuit rendered two decisions within the survey period which dealt with this split of jurisdiction and its effects.

B. Oklahoma Health Services Credit Union v. Webb

In *Oklahoma Health Services Credit Union v. Webb*,[16] the Webbs filed a joint chapter 13 petition and a chapter 13 plan. Prior to the petition, the appellant credit union had repossessed the Webbs' automobile upon their default in payments. The chapter 13 plan called for the return of the automobile to the Webbs with a provision under the plan to cure the default and to resume the required payments. The bankruptcy court entered an order confirming the plan and a second order calling for the return of the automobile to the Webbs.

The credit union appealed both orders.[17] It challenged the jurisdiction of the bankruptcy court, arguing that in *Marathon* the Supreme Court, by invalidating the jurisdictional provision of 28 U.S.C. section 1471(c) of the Bankruptcy Reform Act of 1978, had also invalidated 28 U.S.C. section 1471(a) and (b).[18] Subsections (a) and (b) relate only to the grant of jurisdiction to the district courts; subsection (c) relates to the pervasive jurisdiction of the bankruptcy court.[19]

The Tenth Circuit joined other circuits in rejecting this argument.[20] It held that the split of jurisdiction under the interim operating rule was valid because the district courts retain primary jurisdiction over bank-

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MODEL RULE: JUDICIAL CONFERENCE OF THE UNITED STATES, *reprinted in* A. HERZOG & L. KING, COLLIER PAMPHLET EDITION BANKRUPTCY CODE 665 (1983).

14. *See* A. HERZOG & L. KING, COLLIER PAMPHLET EDITION BANKRUPTCY CODE 665 (¶ (d)(3)(b)) (1983).

15. *Id.* at ¶ (e)(2)(A) and (B).

16. 726 F.2d 624 (10th Cir. 1984).

17. *Id.* at 625.

18. *Id.*

19. 28 U.S.C. § 1471 (1982) reads in part:

Jurisdiction:

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

(c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts. . . .

20. *See* Salomon v. Kaiser, 722 F.2d 1574 (2d Cir. 1983); White Motor Corp. v. Citibank, N.A., 704 F.2d 254 (6th Cir. 1983); First Nat'l Bank of Tekamah, Nebraska v. Hansen, 702 F.2d 728 (8th Cir. 1983), *cert. denied*, 103 S. Ct. 3539 (1983); Braniff Airways, Inc. v. CAB, 700 F.2d 214 (5th Cir. 1983), *cert. denied*, 461 U.S. 944 (1983); *see also* Coastal Steel Corp. v. Tilghman Wheelabrator Ltd., 709 F.2d 190 (3d Cir. 1983), *cert. denied*, 104 S. Ct. 349 (1983).

ruptcy matters.[21] It also rejected the argument that the subject matter of the orders was controlled by state law and that the case was a "related proceeding."[22] It found that the subject matter of the orders was based on the Bankruptcy Code and, therefore, the bankruptcy court had jurisdiction to enter a final order.

C. *In re* Colorado Energy Supply, Inc.

A procedural issue arising out of the interpretation of "related to" proceedings under *Marathon* was raised in *In re Colorado Energy Supply, Inc.*[23] Following the sale of debtor's property, debtor's landlord, Price, applied for immediate payment of his claim for rent from the sale proceeds. The claim was disallowed as a cost of sale. Following the entry of judgment by the bankruptcy court, Price filed a notice of appeal and a motion for extension of time for filing a notice of appeal with both the bankruptcy and district courts. The appeals were denied as the time period allowed by Bankruptcy Rule 802 for filing the notice of appeal and the motion for extension had expired.[24]

On appeal to the Tenth Circuit, Price claimed that the Bankruptcy Rule 802 time period was not applicable to his case.[25] Alternatively, he claimed that his failure to file timely under Rule 802 was due to excusable neglect which he explained had resulted from confusion over the applicable procedural rules due to the *Marathon* decision.[26]

If the matter was a "related to" proceeding, the Bankruptcy Rule 802 time period was inapplicable because the judgment would be final and appealable only after being signed by a district court judge.[27] If however, the proceeding was one arising under title 11, the time period for appeal would run from the entry of judgment by the bankruptcy judge and that time period would have expired. The court noted that Price was attempting to keep his claim alive by seeking a broad interpretation of *Marathon* so as to obtain a ruling that the bankruptcy court had no jurisdiction to render a final order regarding his alleged "related to" claim.[28] The Tenth Circuit found the issue to be purely a bankruptcy matter and again, as in *Webb*, joined other circuits in narrowly interpreting the *Marathon* decision.[29] Finally, the court held that the late filings of the notice of appeal and motion for an extension of time were not due

21. 726 F.2d at 625.
22. *Id.* at 625-26.
23. 728 F.2d 1283 (10th Cir. 1984).
24. Former Bankruptcy Rule 802 required that a notice of appeal be filed with the clerk of the bankruptcy court within 10 days of the date of the entry of the appealed judgment, order, or decree. A request to extend the time for filing a notice of appeal must have been made before the time for filing a notice of appeal expired except that a request made no more than 20 days after the expiration of the time for filing a notice of appeal may have been granted upon the showing of excusable neglect.
25. 728 F.2d at 1284.
26. *Id.* at 1286.
27. *Id.*
28. *Id.* at 1285.
29. *Id.* at 1286-87.

to excusable neglect.[30]

D. *Bankruptcy Amendments and Federal Judgeship Act of 1984*

Subsequent to the holdings in *Webb* and *Colorado Energy Supply*, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA")[31] creating a solution to the problems arising out of *Marathon*. Title I of BAFJA contains jurisdictional provisions; Title II creates 85 additional district and circuit court judgeships; Title III makes significant changes in the Bankruptcy Code in the areas of consumer credit, rejection of labor contracts, discharge of debts incurred by drunk drivers, repurchase agreements, time share agreements and bankruptcies of grain storage facilities and shopping centers. The new court structure created by BAFJA parallels practice under the interim operating rule so closely that it is fair to say the new provisions are in many respects a codification of the interim rule.[32]

Jurisdiction of the district court is set forth in 28 U.S.C. section 1334(a) and (b)[33] as amended, which parallels former 28 U.S.C. section 1471(a) and (b). As under the interim rule, practice under BAFJA is premised on district court jurisdiction of all title 11 cases and related proceedings with reference of any and all cases to the bankruptcy judge for the district. Bankruptcy judges may enter judgment on core proceedings[34] arising under title 11 but may only propose findings and con-

30. *Id.* at 1286.

31. Pub. L. No. 98-353, 98 Stat. 333 (1984).

32. *Special Report: Highlights of H.R. 5174*, CURRENT AWARENESS ALERT, 1984 Issue 5, Part II, at 49 (July, 1984).

33. 28 U.S.C. § 1334 (1984) provides in part:

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

34. 28 U.S.C.A. § 157(b)(2) (West 1984) defines core proceedings as follows:

Core proceedings include, but are not limited to—

(A) matters concerning the administration of the estate;

(B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interest for the purposes of confirming a plan under chapter 11 or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11;

(C) counterclaims by the estate against persons filing claims against the estate;

(D) orders in respect to obtaining credit;

(E) orders to turn over property of the estate;

(F) proceedings to determine, avoid, or recover preferences;

(G) motions to terminate, annul or modify the automatic stay;

(H) proceedings to determine, avoid, or recover fraudulent conveyances;

(I) determinations as to the dischargeability of particular debts;

(J) objections to discharges;

(K) determinations of the validity, extent, or priority of liens;

(L) confirmations of plans;

(M) orders approving the use or lease of property, including the use of cash collateral;

(N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; and

clusions to the district court regarding a proceeding that is non-core but is otherwise related to a case under title 11.

There are also provisions for distinctive treatment of certain proceedings. Upon timely motion of a party, the district court must abstain from jurisdiction of a state law claim or cause of action, and the decision to abstain is not reviewable by appeal or otherwise.[35] Personal injury and wrongful death claims are also singled out for distinctive treatment. These claims must be tried in the district court in which the bankruptcy case is pending or the district court in the district in which the claim arose.[36] The mandatory abstention rules do not apply to personal injury and wrongful death suits.

A negative view of the new bankruptcy legislation was expressed by Congressman Edwards in his remarks before the House of Representatives:

> Mr. Speaker, the conference report H.R. 5174, Bankruptcy Amendments of 1984, is regrettable, at best. It ignores over a decade of study in this issue and creates a maze for debtors, creditors, and their lawyers who participate in the bankruptcy process . . . . The conference report before us today turns back the clock, and it does so more than just 6 years by diminishing the status of bankruptcy judges and their powers from what they were before the 1978 legislation . . . . Finally, and very importantly, the jurisdictional powers granted to the bankruptcy judge and the methods of appointment are not free from constitutional doubt, which is what got us into this in the first place under the 1978 compromise.[37]

His view is shared by many bankruptcy practitioners who believe the only real solution is to give article III status to bankruptcy judges.[38]

As Congressman Edwards pointed out, there is concern over the constitutionality of the provisions which extend the terms of bankruptcy judges. These terms technically expired on June 27, 1984, the day that the last Congressional deadline passed without new legislation having been enacted. One could argue that this congressional extension of authority amounts to appointment of judges by Congress. The appointment clause[39] of the United States Constitution vests appointment authority in the executive branch and the judicial branch rather than in the legislative branch.

(O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims.

35. 28 U.S.C.A. § 1334(c)(2) (West 1984).

36. 28 U.S.C.A. § 157(b)(5) (West 1984).

37. 130 CONG. REC. 7489 (daily ed. June 29, 1984) (statement of Rep. Edwards).

38. *See* Norton and Lieb, *Ending the Bankruptcy Jurisdiction Dilemma—An Article III Bankruptcy Court Approach*, 67 JUDICATURE 346 (1984). *But cf.* DeMascio, *Bankruptcy A Solution In Search Of A Problem*, 67 JUDICATURE 354 (1984) (a separate article III bankruptcy court is both unnecessary and unwise).

39. [T]he Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments. U.S. CONST. art. II, § 2, cl.2.

William E. Foley, Director of the Adminstrative Office of the United States Courts, responded to BAFJA just one day after it was signed into law. He sent a memorandum to all circuit judges, district court judges and *former* bankruptcy judges. He stated his concern with the constitutionality of BAFJA and announced his decision not to pay any former bankruptcy judge purporting to exercise judicial authority under the new provisions of 28 U.S.C. section 121. He stated:

> If the purpose served by the provision is interpreted to be equivalent to a new appointment of individuals to the offices they held on June 27, there is a very real possibility, in light of the Supreme Court's decision in *Buckley v. Valeo*, 424 U.S. 1 (1976), that the section will be held to be unconstitutional when challenged. In that event decisions by bankruptcy judges relying upon section 121 for their grants of judicial authority may all be invalidated, extensively disrupting the bankruptcy system and inconveniencing bankruptcy litigants.[40]

Since July 10, 1984, the bankruptcy system has been operating under the jurisdictional provisions of BAFJA. New constitutional challenges loom on the horizon just months after the Tenth Circuit upheld in *Webb* and *Colorado Energy Supply* the validity of 28 U.S.C. section 1471 (a) and (b) and the jurisdictional system established by the interim operating rule.

II. Debtors' Strict Duty to Give Formal Notice to Creditors

In *Reliable Electric Co. v. Olson Construction Co.*,[41] the Tenth Circuit held that the claim of Olson Construction Company, appellee, was not dischargeable and not subject to the debtor's plan of reorganization because the debtor, Reliable, had not given Olson sufficient notice of the bankruptcy confirmation hearing.[42] Rejecting Reliable's "fresh start" argument, the court stated that Olson's guaranteed right to due process was paramount to the "all encompassing" language of section 1141[43]

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40. Memorandum to all circuit, district and former bankruptcy judges, W.E. Foley, Director, Admin. Office of the United States Courts, July 11, 1984.

41. 726 F.2d 620 (10th Cir. 1984).

42. *Id.* at 623.

43. 11 U.S.C. § 1141 (1982) provides in pertinent part:

(a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind . . . any creditor . . . of . . . the debtor, whether or not the claim or interest of such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.

. . .

(c) After confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors . . . except as otherwise provided in the plan or in the order confirming the plan.

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—

(A) discharges the debtor from any debt that arose before the date of such confirmation . . . whether or not—

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan . . . .

under the circumstances presented in the case.[44]

Olson received actual knowledge of the chapter 11 proceedings through a phone call from Reliable's attorney. Olson was also a defendant and counter-claimant in a breach-of-contract action within the bankruptcy proceeding. Despite the fact that Olson had counterclaimed for damages, Reliable had failed to schedule Olson as a contingent creditor. As a result, Olson did not receive notice of the time for filing an acceptance or rejection of the reorganization plan, of the confirmation hearing, of the time for filing objections to the confirmation, or of the confirmation and discharge of Reliable. After confirmation of the plan and after judgment for Olson in the breach of contract action, Reliable moved the court to allow the judgment as a prepetition unsecured claim. By doing so, the claim would be subject to the confirmed plan of reorganization and, therefore, dischargeable.[45] Under the plan, class four unsecured debt was substantially impaired, and Olson would have been forced to share in the distribution to the class four unsecured creditors on a percentage basis.

Applying the standard of reasonable notice outlined by the United States Supreme Court in *Mullane v. Central Hanover Trust Co.*,[46] the Tenth Circuit held that due process requires that creditors be given notice which is reasonably calculated under all the circumstances to apprise them of the pending confirmation and which gives them the opportunity to present their objections.[47] A creditor who has general knowledge of a debtor's reorganization proceedings has no duty to inquire about further court action.[48] A creditor has a "right to assume" that he will receive all of the notices required by statute before his claim is forever barred.[49] This case should serve as a warning to all debtors and their attorneys that there is a strict duty to give formal notice of bankruptcy proceedings to all potential creditors.

III. Retrospective Application of Law

A. *Child Support: Law in Effect at Time of Filing Determines Dischargeability*

At issue in *Franklin v. State of New Mexico ex. rel. Department of Human Services*[50] was the dischargeability of child support payments owed to the State of New Mexico. Franklin, the debtor and appellee, was the alleged father of an illegitimate child. The State of New Mexico had provided economic assistance to the child when the debtor failed to pay child support. The dischargeability of the debt to the State depended on whether the law in effect at the time of filing the bankruptcy petition or the

44. 726 F.2d at 623 n.6.
45. 11 U.S.C. § 1141(a) and (d)(1) (1982).
46. 339 U.S. 306 (1950).
47. 726 F.2d at 622.
48. *Id.* (citing New York v. New York, New Haven & Hartford R.R. Co., 344 U.S. 293, 297 (1953)). *See also In re* Intaco Puerto Rico, Inc., 494 F.2d 94, 99 (1st Cir. 1974); *In re* Harbor Tank Storage Co., 385 F.2d 111, 115 (3d Cir. 1967).
49. 726 F.2d at 622.
50. 730 F.2d 86 (10th Cir. 1984).

amended law in effect at the time of the hearing on dischargeability should apply.[51] The Tenth Circuit held that the date of filing is determinative.[52] In doing so, it followed the rule under *Bradley v. Richmond School Board*,[53] which dictates that a court must apply the law in effect at the time it renders its decision unless doing so would result in manifest injustice or unless there is statutory or legislative history to the contrary.[54] The Tenth Circuit balanced the nature of the parties, the nature of their rights and the resulting impact the change in the law had on those rights, and determined that an injustice would result if the discharge law were applied restrospectively.[55] The court pointed out that the Bankruptcy Act provides a legislative scheme in which the time of filing is determinative of many substantial rights.[56] The court also noted the absence of language within the 1981 amendment to the Code which would indicate a legislative intent that the amendment apply retrospectively.[57]

B. *"Gap Period" Liens*

The Tenth Circuit decision *In re Groves*[58] involved a consolidation of four cases in which debtors attempted to avoid nonpossesory, nonpurchase-money liens on certain property pursuant to section 522(f)(2).[59] The issue decided in each case was whether section 522(f)(2) applied to "gap period" liens. The court defined a "gap period" lien as a lien created "after the enactment but before the effective date of the Bankruptcy Reform Act of 1978."[60] The bankruptcy court held that application of section 522(f)(2) to such liens would impair vested property rights and therefore violate due process. The United States, intervenor in the bankruptcy proceedings, appealed directly to the Tenth Circuit. The Tenth Circuit adopted the analysis of the Ninth Circuit in *In re Webber*[61] and reversed. In *Webber*, the Ninth Circuit found that Congress intended that section 522(f)(2) should apply to gap period liens and that application of section 522(f)(2) to such liens did not violate due process because creditors acquiring liens during the gap pe-

51. Prior to October 1, 1979, support obligations owed to the state were nondischargeable. This type of debt became dischargeable after that date pursuant to the 1978 Bankruptcy Reform Act, 11 U.S.C. § 523(a)(5). On August 13, 1981, the Code was amended by the Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97-35, 95 Stat. 357 § 2334(b) and (c) to again disallow the discharge of this type of debt.

52. 730 F.2d at 87.

53. 416 U.S. 696 (1974).

54. *Id.* at 697.

55. 730 F.2d at 87-88.

56. *Id.* at 87. For example, rights pertaining to the operation of the automatic stay, the evaluation of secured claims, and the determination of what constitutes property of the estate are determined as of the date of filing. *See* 11 U.S.C. §§ 362, 506 and 541 (1982).

57. 730 F.2d at 87 (citing Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97-35, § 2334(c), 95 Stat. 863 (1981)).

58. 707 F.2d 451 (10th Cir. 1983).

59. 11 U.S.C. § 522(f)(2) (1982).

60. 707 F.2d at 452. The "gap period" extends from Nov. 6, 1978, the date of enactment, through October 1, 1979, the effective date. *Id.* at 452 n.1.

61. 674 F.2d 796 (9th Cir.), *cert. denied*, 459 U.S. 1086 (1982).

riod had notice of the future effect of the Act.[62]

Judge Barrett, dissenting in *Groves*, refused to put the creditors "on notice" of section 522(f)(2) until the effective date of the Act.[63] He argued that the creditors' security interests in the property of the debtors were property interests which could not be taken without due process of law. Judge Barrett criticized the majority opinion for imputing notice to creditors from the date of enactment, and supported the prospective application of new law where Congress is silent on retroactive application.[64]

The holding of the Tenth Circuit in *Groves*,[65] decided May 16, 1983, and in *Franklin*,[66] decided March 26, 1984, are inconsistent regarding retroactive application of new law. The Bankruptcy Reform Act of 1978 provided that the majority of its provisons would take effect on October 1, 1979. There was *no* provision for any section to be retroactively applied, yet the majority in *Groves* found retroactive application to be "intended."[67] In contrast, the majority opinion in *Franklin* noted that the effective date of the Code amendment was the date of enactment and thus found an intent for prospective application. The *Franklin* majority stated, "[t]his court generally disfavors retrospective application of a law without a clear expression of legislative intent . . . ."[68]

At best, the *Groves* decision will create only minimal confusion regarding whether the enactment date or effective date controls the various provisions of the Reform Act of 1978. At worst, if liberally interpreted, *Groves* could render meaningless statutory effective dates. The general rule, however, as quoted by dissenting Judge Barrett, should still prevail: "Acts of Congress are generally to be applied uniformly throughout the country from the date of their effectiveness onward."[69]

IV. Impact of State Law on Federal Bankruptcy Law

A. *Res Judicata and Collateral Estoppel*

In *In re Colorado Corp.*,[70] the limited partners of Green Mountain 69 (Green Mountain) sued The Colorado Corporation (TCC) for additional distributions from the liquidation of Green Mountain. Green Mountain was formed to finance drilling operations on Green Mountain properties, and TCC was its general partner. The 1969 limited partnership agreement provided that certain payments be made by each of the lim-

62. *Id.* at 804.
63. 707 F.2d at 453 (Barrett, J., dissenting).
64. *Id.*
65. *See supra* notes 58-64 and accompanying text.
66. *See supra* notes 50-57 and accompanying text.
67. 707 F.2d at 452.
68. 730 F.2d at 87 (citing Edgar v. Fred Jones Lincoln-Mercury of Oklahoma, Inc., 524 F.2d 162 (10th Cir. 1975)).
69. *Groves*, 707 F.2d at 553 (Barrett, J., dissenting) (quoting United States v. Estate of Donnelly, 397 U.S. 286, 294 (1974)).
70. No. 81-2177 (10th Cir. filed June 20, 1983).

ited partners to provide capital for drilling. When the plaintiffs defaulted on their final payments, TCC purchased their interests as provided by the agreement. The limited partnership agreement was then amended to reflect the modified list of partners and their capital contributions.

When TCC was adjudicated bankrupt, the limited partners of Green Mountain filed for reclamation of their share of the Green Mountain mineral interests (Green Mountain-1). In response, the trustee attempted to reject the limited partnership agreement as an executory contract. The limited partners then filed a stipulation of facts which acknowledged the purchase by TCC of the interests of certain defaulting limited partners.[71] The bankruptcy court held that the limited partnership agreement was not executory and had been fully performed with all monies having been paid. The court also held that TCC, as general partner, could wind up the affairs of the limited partnership and liquidate its assets. Green Mountain was subsequently liquidated, and the proceeds were distributed according to the interests set out in the amended limited partnership agreement. At that time, the limited partners raised no objection to the distribution; however, in 1978, they filed an action for an accounting. This second action for an accounting, Green Mountain-2, was appealed to the Tenth Circuit.

In Green Mountain-2, the bankruptcy court granted the trustee's motion for summary judgment, finding plaintiffs' claim barred by res judicata. The district court affirmed,[72] finding that the underlying facts and issues relevant to the holding in the reclamation proceeding, Green Mountain-1, were the same facts and issues which the defaulting limited partners were attempting to relitigate in their claim for an accounting in Green Mountain-2. The limited partners argued before the Tenth Circuit that there was no similarity of issues of fact between the actions; that there was not a full and fair opportunity to litigate the accounting in Green Mountain-1; that there was no threat of inconsistency of rulings; and that the limited partners were not on notice that the facts pertinent to the repurchase were necessary to the determination of Green Mountain-1.[73]

The Tenth Circuit addressed each of the limited partners' arguments and concluded that to rule in their favor would contradict the central holding in Green Mountain-1 (that the limited partnership agreement was not executory and that TCC had fully performed by pay-

71. The limited partners filed a stipulation of facts which stated in part:
> By amendment, dated January 31, 1971, and recorded in Denver, Colorado, on February 11, 1971, the certificate of limited partnership for Green Mountain-69 was amended to reflect that as of October 26, 1970, pursuant to the default and repurchase provisions of the Partnership Agreement, certain defaulting Limited Partners had sold their interest to TCC so that TCC had contributed $294,271.66 of the $798,600 required of the Limited Partners, and thereby re-acquired approximately 37% of ten Limited Partners' 30% interest . . . .

Colorado Corp., No. 81-2177, slip op. at 4.

72. No. CIV 81-F-402 (D.C. Colo. filed August 31, 1981).

73. *Colorado Corp.*, No. 81-2177, slip op. at 6.

ing all monies as set forth in the amended agreement and as stipulated by the plaintiffs). In response to the limited partners' argument that the application of res judicata against them was unfair, the circuit court quoted the United States Supreme Court in *Federated Department Stores, Inc. v. Moitie*,[74] stating that "[t]he doctrine of res judicata serves vital public interests beyond any individual judge's ad hoc determination of the equities in a particular case."[75]

The Tenth Circuit also addressed the application of collateral estoppel in *Goss v. Goss*.[76] A state court determined that the obligations embodied in the debtor's divorce decree were in the nature of maintenance and support and, therefore, were nondischargeable under former Bankruptcy Act section 17a(17).[77] In a subsequent bankruptcy proceeding, the Bankruptcy Court for the Eastern District of Oklahoma held that it was not bound by the prior state court judgment. The bankruptcy court concluded that the judgment awarded in the divorce decree constituted a property settlement, not alimony, and thus was dischargeable. The Tenth Circuit reversed and held that the doctrine of collateral estoppel should have been applied in the bankruptcy proceeding.[78]

The court distinguished the application of res judicata (claim preclusion) and collateral estoppel (issue preclusion):[79] "[w]hereas res judicata forecloses all that which might have been litigated previously, collateral estoppel treats as final only those questions actually and necessarily decided in a prior suit."[80] The court also recognized that application of these concepts may differ if the bankruptcy court has exclusive jurisdiction to determine dischargeability as opposed to concurrent jurisdiction with state courts.[81]

The United States Supreme Court in *Brown v. Felsen*[82] held that res judicata does not prevent a bankruptcy court from going beyond the judgment and record of a prior state court proceeding to determine debt dischargeability under section 17a(2) and (4) of the former Act.[83] In *Goss*, the Tenth Circuit distinguished *Brown* because in that case the dischargeability of debt had been under the exclusive juridiction of the bankruptcy court; also *Brown* dealt only with res judicata, explicitly leaving open the question of whether collateral estoppel should apply to a state court judgment in the face of exclusive jurisdiction in the bank-

74. 452 U.S. 394 (1981).
75. *Id.* at 401.
76. 722 F.2d 599 (10th Cir. 1983).
77. 11 U.S.C. § 35(a)(7) (1976) (repealed 1978).
78. 722 F.2d at 604.
79. *See generally* M. GREEN, BASIC CIVIL PROCEDURE 234-41 (2d ed. 1979).
80. 722 F.2d at 602 (quoting Brown v. Felsen 442 U.S. 127, 139 n.10 (1979)).
81. Section 17c(2) of the 1976 Bankruptcy Act grants exclusive jurisdiction to bankruptcy courts to determine dischargeability of debts under § 17a(2), (4) and (8). 11 U.S.C. § 35(a)(2), (4), (8) (1976). State courts possess jurisdiction concurrent with that of the bankruptcy courts to determine dischargeability, with respect to other classes of debts under § 17a, including debts for alimony or maintenance and support under § 17a(7). 722 F.2d at 602.
82. 442 U.S. 127 (1979).
83. *Id.* at 138.

ruptcy court.[84] The Tenth Circuit did not rule on whether, within its jurisdiction, collateral estoppel should apply in a dischargeability determination involving a bankruptcy court's exclusive jurisdiction. The circuits are divided on this question.[85] In a situation where the states have been granted concurrent jurisdiction, however, collateral estoppel will apply when, as in this case, the elements of collateral estoppel are satisfied.[86]

B. *Constitutionality of Colorado Bankruptcy Exemptions*

In *Hinkson v. Pfleiderer*,[87] the Tenth Circuit addressed the constitutionality of the Colorado bankruptcy exemptions. Hinkson, a chapter 7 debtor, claimed certain federal exemptions provided by section 522(d).[88] The trustee objected. In response, Hinkson challenged the constitutionality of Colorado Revised Statutes section 13-54-107 which in part denies section 522(d) exemptions to Colorado citizens pursuant to an option in the Code.[89] He claimed the provision in the second sentence of the two-sentence statute offended the supremacy clause[90] because it prevented him from claiming certain "nonbankruptcy exemptions," meaning those not contained in section 522(d) but provided by other federal and state laws.

The Tenth Circuit upheld the bankruptcy court's ruling that Hinkson could not claim the federal exemptions contained in section 522(d) because Colorado had "opted out" of providing its citizens such an exemption.[91] The Tenth Circuit also held that Hinkson lacked standing to

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84. *Id.* at 139, n.10.

85. Some courts have held that collateral estoppel does apply in this situation. *See, e.g., In re* Rahm, 641 F.2d 755, 756 n.2, 757 (9th Cir.), *cert. denied*, 454 U.S. 860 (1981) (§ 17a(8); *In re* Kasler, 611 F.2d 308, 309-10 (9th Cir. 1979) (§ 17a(8). Other courts, however, have applied collateral estoppel where the issue was previously litigated by the parties in state court, despite the existence of exclusive jurisdiction in the bankruptcy court. *See, e.g.*, Spilman v. Harley, 656 F.2d 224, 227 (6th Cir. 1981) (§ 17a(8), *In re* Ross, 602 F.2d 604, 607-08 (3d Cir. 1979) (§ 17a(2).

86. The elements of collateral estoppel are:

(1) The issue decided in the prior adjudication must be identical with the issue in the present action.

(2) There must have been a final judgment rendered.

(3) The party against whom an issue is to be precluded must have been a party or in privity with a party in the prior case.

(4) The party against whom the doctrine is asserted must have had a full and fair opportunity to litigate in the prior case.

(5) The determination of the issue was essential to the judgment.

See generally C. WRIGHT, FEDERAL COURTS at 682-85 (4th ed. 1983).

87. 729 F.2d 697 (10th Cir. 1984).

88. *See* 11 U.S.C. § 522(d) (1982).

89. Colo. Rev. Stat. § 13-54-107 (Supp. 1984) reads:

The exemptions provided in section 552(d) of the federal bankruptcy code of 1978 (Title 11 of the United States Code), as amended, are denied to residents of this state. Exemptions authorized to be claimed by residents of this state shall be limited to those exemptions expressly provided by the statutes of this state.

COLO. REV. STAT. § 13-54-102 (Supp. 1984) lists the exemptions which substitute for the federal § 522(d) exemptions.

90. U.S. CONST. art. VI, cl. 2.

91. This ruling is consistent with the position taken by other circuits. *See*, First Nat'l Bank of Mobile v. Norris, 701 F.2d 902, 904 (11th Cir. 1983); *In re* Sullivan, 680 F.2d

challenge a part of the Colorado statute which did not affect him; although Hinkson challenged the constitutionality of the second sentence of section 13-54-107, it was the first sentence which denied him the federal exemption. The Tenth Circuit noted that it was a "close question" whether the Colorado statute precludes a debtor from claiming other federal non-code exemptions.[92]

The Colorado bankruptcy court has since ruled on the constitutionality of the second sentence. On June 24, 1984, in *Ranes v. Molen*,[93] Judge Brumbaugh of the United States Bankruptcy Court, for the District of Colorado, held the Colorado statute did not deny "nonbankruptcy exemptions" to its citizens. The parties have not appealed the decision.

C. *Releasing a Joint Tortfeasor—Effect on Dischargeability of Debt*

In *LeaseAmercia Corp. v. Eckels*,[94] the Eckels were the owners and developers of an equestrian facility. They entered into a lease agreement with LeaseAmerica whereby LeaseAmerica would purchase a sound system and portable stalls and lease them to the Eckels. The sound system was purchased from David Beatty. Beatty quoted the price of the sound system as $18,484 in a letter to LeaseAmerica. The actual cost of the sound system was $7,810. LeaseAmerica paid the $18,484 to the Eckels, who in turn paid Beatty for the system and retained $10,674. LeaseAmerica also paid Harold Krug $183,200 for the portable stalls. The stalls actually cost $159,600. Krug remitted $23,600 to the Eckels. Evidence indicated that the Eckels participated in both transactions intentionally and without the knowledge or consent of LeaseAmerica. The Eckels later filed a chapter 11 petition in bankruptcy. LeaseAmerica filed a complaint contesting the dischargeability of the $10,674 and $23,600 debts. The bankruptcy court in Kansas held that these debts were nondischargeable because they constituted a willful and malicious conversion of funds.

LeaseAmerica also sued David Beatty for the $10,674 in Missouri state court. More than a year and a half after the bankruptcy court had held the debt nondischargeable as to the Eckels, LeaseAmerica and Beatty entered into a compromise settlement. Under the settlement, Beatty agreed to pay LeaseAmercia $3,750 and court costs, and LeaseAmercia gave Beatty a complete and unconditional release. Just a month after the settlement, the federal district court in Kansas affirmed the bankruptcy court's holding that the debts were nondischargeable.

The Eckels responded by filing a motion for relief from judgment under Federal Rules of Civil Procedure 60(b)(5) and (6).[95] They argued

1131, 1132 (7th Cir. 1982); *In re* Canaday, 653 F.2d 210, 214 (5th Cir. 1981); *see generally* 3 COLLIER ON BANKR. ¶ 522.02 at 522-11 (15th ed. 1983) (listing states which do not provide 522(d) exemptions).

92. 729 F.2d at 699.

93. 31 Bankr. 70 (Colo. 1983).

94. 710 F.2d 1470 (10th Cir. 1983).

95. FED. R. CIV. P. 60(b)(5) and (6). The rule provides in pertinent part:

that the compromise settlement with a full release effectuated by LeaseAmerica and Beatty constituted the unconditional release of a joint tortfeasor, and that, under Kansas law, the unconditional release of one tortfeasor acts as an unconditional release of all joint tortfeasors. In denying the Eckels' motion for relief from judgment, the district court reasoned that the agreement between LeaseAmerica and Beatty did not affect that part of the indebtedness found nondischargeable by the bankruptcy court. The district court emphasized the Eckels' "willful and malicious conversion" of the funds and refused to excuse the Eckels from accountability.[96]

The Tenth Circuit, finding no manifest abuse of discretion on the part of the district court, affirmed. In the opinion, Judge Barrett noted several relevant facts: Beatty was sued in Missouri while the bankruptcy was filed in Kansas; the Eckels were not parties to the Missouri lawsuit and did not appear therein; and the Eckels were not represented by counsel in the Missouri proceedings. Judge Barrett reasoned that "[n]othing in the record . . . support[ed] the Eckels' bald assertion that they were actually joint tortfeasors in the Missouri action or that the settlement and release in full effectuated between the parties in Missouri was binding upon the federal district court in Kansas for purposes of evaluating a rule 60(b) motion."[97] The opinion implies that the willful and malicious conversion of funds is the heart of the matter. The court stated: "We concur in the district court's observation that 'to grant the relief requested would mean that the Eckels would be excused from any accountability despite their 'willful and malicious conversion' of funds—the very act which under the law made the indebtedness nondischargeable.' "[98]

The *LeaseAmerica* opinion is unclear as to whether facts, legal principles or equitable considerations governed the Tenth Circuit's holding. The opinion does not indicate whether a release prior to a determination of nondischargeability or prior to a bankruptcy petition would reverse the holding. Absent more detailed reasoning, it is difficult to determine what impact state laws governing the release of joint tortfeasors may have upon the nondischargeability of debts falling under section 523(a)(b).

V. Good Faith Proposals in a Chapter 13 Plan

In *Flygare v. Boulden*,[99] the debtors' first proposed chapter 13 plan was denied confirmation, and the case was dismissed. Three months

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On motion and upon such terms as are just, the court may relieve a party or his legal representative from a final judgment, order, or proceeding for the following reasons: . . . (5) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or (6) any other reason justifying relief from the operation of the judgment. . . .

96. 710 F.2d at 1475.

97. *Id.*

98. *Id.*

99. 709 F.2d 1344 (10th Cir. 1983).

later the debtors filed a second petition which was similar to the first. The debtors' second proposed plan called for payment to the trustee of $106 per month for five years. Under the plan, unsecured creditors would receive approximately one to two percent of their claims. The bankruptcy court again refused to confirm the plan. At issue was whether payment to unsecured creditors of one or two percent of the debts owed them would satisfy the good faith requirement of section 1325(a)(3).[100] Controversies concerning good faith under chapter 13 resulted in more litigation than almost any other issue during the year immediately following the effective date of the Bankruptcy Code.[101]

The court in *Flygare* noted that the various bankruptcy court interpretations of the "good faith" requirement fall into three broad categories. One interpretation requires substantial or meaningful repayment in all cases.[102] The second interpretation requires only that creditors receive as much as they would receive under chapter 7.[103] The third interpretation, a "middle road" approach, inquires on a case by case basis into whether the plan abuses the provisions, purpose or spirit of chapter 13. The Tenth Circuit joined six other circuits[104] in adopting a formulation of the "middle road" approach and specifically adopted the factors considered relevant to a determination of good faith by the Eighth Circuit.[105] The court stated, "We agree with the Eighth Circuit

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100. 11 U.S.C. § 1325(a)(3) (1982) provides in pertinent part:
Confirmation of plan.
(a) The court shall confirm a plan if
. . . (3) the plan has been proposed in good faith and not by any means forbidden by law. . . .

101. 5 COLLIER ON BANKR. ¶ 1325.01[2][C] at 1325-8.6 (15th ed. 1983).

102. *See, e.g., In re* Iacovoni, 2 Bankr. 256 (Bankr. D. Utah 1980).

103. 11 U.S.C. § 1325(a)(4) (1982) provides that the court shall confirm the plan if ". . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date."

104. *In re* Kitchens, 702 F.2d 885 (11th Cir. 1983); *In re* Estus, 695 F.2d 311 (8th Cir. 1982); *In re* Deans, 692 F.2d 968 (4th Cir. 1982); *In re* Barnes, 689 F.2d 193 (D.C. Cir. 1982); *In re* Goeb, 675 F.2d 1386 (9th Cir. 1982); *In re* Rimgale, 669 F.2d 426 (7th Cir. 1982).

105. *See In re* Estus, 695 F.2d 311, 317 (8th Cir. 1982). The factors are:
(1) the amount of the proposed payments and the amount of the debtor's surplus;
(2) the debtor's employment history, ability to earn and likelihood of future increases in income;
(3) the probable or expected duration of the plan;
(4) the accuracy of the plan's statements of the debts, expenses and percentage repayment of unsecured debt and whether any inaccuracies are an attempt to mislead the court;
(5) the extent of preferential treatment between classes of creditors;
(6) the extent to which secured claims are modified;
(7) the type of debt sought to be discharged and whether any such debt is nondischargeable in Chapter 7;
(8) the existence of special circumstances such as inordinate medical expenses;
(9) the frequency with which the debtor has sought relief under the Bankruptcy Reform Act;
(10) the motivation and sincerity of the debtor in seeking Chapter 13 relief; and
(11) the burden which the plan's administration would place upon the trustee.
Id.

that '[a] per se minimum payment requirement to unsecured creditors as an element of good faith would infringe on the desired flexibility of Chapter 13 and is unwarranted.' "[106] The Tenth Circuit reversed and remanded for further proceedings consistent with the opinion.

Congress has recently responded to the litigation which has centered around the good faith issue. The Bankruptcy Amendments and Federal Judgeship Act of 1984,[107] enacted July 10, 1984 amended section 1325(b) to provide that, upon objection by the trustee or by the holder of an allowed unsecured claim, the court *cannot* confirm the plan unless the claims are to be paid in full, or unless all of the debtor's projected disposable income in the subsequent three year period will be applied under the plan. Disposable income is that income in excess of what is reasonably necessary for support of the debtor and dependents, or, if the debtor is in business, that which is necessary for the preservation, conservation and operation of the business. If a debtor has no excess income over necessary expenses, then it is possible to make a zero payment to unsecured creditors.

One likely result of this new provision is that the trustee and interested parties will scrutinize the budget of the debtor more carefully than in the past. Accordingly, courts will be asked to decide if a debtor's budget is reasonable. It is not clear at present what dollar amount or what budget items the courts will find reasonably necessary for support. It is also unclear what standard of reasonableness will apply.

Some inequity is likely to result in the application of the new provision because the excess disposable income paid into the plan can go toward payment of attorneys' fees, tax and priority claims, secured claims and unsecured claims. The debtor who has secured debt or taxes to pay under the plan will pay less to unsecured creditors than a debtor with the same amount of excess disposable income who has no secured debt or taxes due. The debtor with a secured debt will, in effect, be purchasing something through the plan rather than making any repayment to unsecured creditors while meeting the new statutory provisions.

Although at first glance the new section 1325(b) appears to provide unsecured creditors with more meaningful repayment than under the Bankruptcy Reform Act of 1978, there still exists the potential for debtors to structure their budgets and plans in order to minimize repayment to unsecured creditors. While Congress has attempted to reduce the abuses which occurred under the chapter 13 provisions of the 1978 Act, the amendment to section 1325 may well be subjected to as much litigation as its predecessor has been in the past.

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106. 709 F.2d at 1348 (quoting *In re* Estus, 695 F.2d at 316 (footnotes omitted)).

107. Pub. L. No. 98-353, 98 Stat. 333 (1984). *See also supra* text accompanying notes 31-40.